

Change in CHF value between 27 Dec 2005 and 27 Dec 2010

	27 Dec 2005	27 Dec 2010	% change	CHF:
Australian dollar	1.048	1.038	-0.95%	depreciated by 0.95%
Euro	0.642	0.793	23.52%	appreciated by 23.52%
Japanese yen	89.001	86.342	-3.08%	depreciated by 3.08%
UK pound sterling	0.440	0.676	53.64%	appreciated by 53.64%
US dollar	0.761	1.043	37.06%	appreciated by 37.06%

Exercise 1

Determine whether the following statements are true or false. Explain your answers. Use a diagram to illustrate if possible.

- Higher inflation, ceteris paribus, will create pressure for the exchange rate to decrease in value.
- Easy monetary policy in the USA will, ceteris paribus, create pressure on the Brazilian currency to appreciate in value.
- Whenever there is excess demand for a currency in the foreign exchange market there will be a tendency for its value to increase.
- If in a fixed exchange rate system there is pressure for the currency to weaken, the central bank will defend it by selling it and/or by lowering interest rates to induce financial capital inflows.
- A benefit of an appreciating currency is that it may force domestic firms (both exporters and import-competing firms) to become more efficient.

Exercise 2

Assume a sharply appreciating currency. Make a list of the possible consequences on the economy.

Exercise 3

Rewrite the following statements and fill in the blanks by using the terms provided below. Some terms may be used more than once or not at all.

periodic	attractiveness	certainty
flexible	opportunity cost	price
monetary	devaluation	unemployment
competitiveness	fiscal	decreases
interest	depreciating	widening
reserves	deficits	
inflation	managed	

The term (1)_____ is reserved to describe a decrease in the price of a currency in a fixed exchange rate system. A weakening currency in a floating (also, referred to as a (2)_____ system) is known as a (3)_____ currency.

A major advantage of a fixed regime is the increased (4)_____ in conducting trade-related business and cross-border investments. Firms and investors alike do not

have to worry about movements in the exchange rate which would change the relative (5)_____ of exports and imports as well as the (6)_____ of both portfolio and foreign direct investments. In addition, governments are forced to keep (7)_____ under control as otherwise export (8)_____ would be eroded and (9)_____ trade deficits are not compatible with fixed exchange rates.

On the other hand, a major drawback is that policymakers are deprived of (10)_____ policy. They can not lower (11)_____ rates to boost economic activity as this would lead to devaluation. Also, trade (12)_____ have to be corrected by adopting contractionary (13)_____ policy so that national income (14)_____ and imports decrease. This implies higher (15)_____. Lastly, the central bank must maintain sizable foreign exchange (16)_____ at a high (17)_____ to be able to intervene in the foreign exchange market and maintain the parity.

(18)_____ exchange rates involve (19)_____ intervention by the authorities whenever exchange rates move too fast or in the wrong direction.